UNITED STATES OF AMERICA Before the COMMODITY FUTURES TRADING COMMISSION

LAWRENCE SANCHEZ

V

BRUCE NORMAN CROWN, LORI ANN DENN, INVESTORS TRADING GROUP LC, TECH NET TRADING INC. CFTC Docket No. 02-R050°C

A Judgment Officer awarded complainant Lawrence Sanchez ("Sanchez") \$24,396 in damages upon finding that respondent Lori Ann Denn ("Denn") fraudulently induced him to trade deep-out-of-the-money commodity options. The Judgment Officer held that her conduct violated Section 4c(b) of the Commodity Exchange Act ("Act") and Commission Rules 33.7 and 33.10. The Judgment Officer found that respondent Bruce Norman Crown ("Crown") reinforced the false impression created by Denn and failed to diligently supervise her, thereby violating Section 4c(b) of the Act and Commission Rules 33.10 and 166.3. He held their employer, Investors Trading Group, LC ("ITG"), derivatively liable for the damage award under the Act. Finally, he held respondent Tech Net Trading, Inc. ("TNT") liable for the award pursuant to its guarantee agreement with ITG.\(^1\) Sanchez v. Crown, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) \(^1\) 29,487 (Initial Decision May 16, 2003) ("I.D.").

All respondents appealed, stressing the Judgment Officer's alleged procedural errors.

Complainant filed no answering brief. For the reasons that follow, we affirm liability against

Denn and the corporate respondents, and dismiss the complaint against Crown.

¹ At the time of the events at issue, ITG was registered as an introducing broker, TNT was registered as a futures commission merchant ("FCM"), and Denn and Crown were registered as associated persons ("AP"). Shortly after Sanchez filed a formal complaint, both ITG and TNT withdrew their registrations.

BACKGROUND

Prehearing Proceedings

Sanchez filed a complaint seeking approximately \$24,000 in damages for wrongdoing that he described as "unsuitable investment," "lies and deceit," failure to disclose, and failure to protect his investment. Sanchez named Denn, ITG, and TNT as respondents.

Sanchez stated that he contacted respondents in February 2000 after viewing a television show that was recruiting investors. He alleged that Denn promised to "educate" him and told him that in June and July gas prices would "sky rocket." Complaint at 2. He opened an account. Sanchez claimed that when Denn told him that his investment was doing well, he asked her to cash in, but she refused. Later, when he suffered losses, he said she told him that time "[ate] up" his investment. *Id.* at 3. Sanchez claimed that respondents sold him a "phony" investment that was supposedly risk-free, but took no steps to protect it. *Id.* at 1, 3.

Denn, ITG, and TNT filed a joint answer denying all wrongdoing and offering their own version of the facts. Respondents contended that Sanchez was so "eager to invest" that he asked Denn to fax the account-opening packet to him at his bank, although she already had shipped a packet by priority mail. Respondents' Answer at 3. The answer claims that Sanchez indicated that he had an annual income of over \$25,000 and a net worth (exclusive of his residence) of \$80,000. Respondents asserted that before Sanchez began trading, he received Denn's oral risk disclosure, a written disclosure statement, and additional risk disclosure by a compliance officer. Respondents' Answer at 5-6. They denied that Denn said prices would "sky rocket" or otherwise misrepresented profit potential.

Respondents agreed that Denn recommended Sanchez's purchase of June unleaded gasoline call options on February 29, 2000, but disputed his allegation that she dissuaded him

from taking profits. They stated that on March 7, 2000, instead of following Denn's recommendation to sell with an \$11,000 profit, Sanchez purchased additional unleaded gas options. Respondents claimed that in a subsequent conversation, after incurring losses, Sanchez asked Denn for recommendations in other markets and she referred him to Crown, who recommended without success that Sanchez sell his losing unleaded gas position and purchase soybean options. Respondents contended that, on March 21 and again on March 29, 2000, Sanchez refused to take Denn's advice to sell his gas options. Sanchez's account was then transferred to another broker.²

Respondents served discovery requests on Sanchez seeking, inter alia, "[a]ll tape recordings of any telephone calls relating to your account which is the subject of this litigation." Respondents' First Request for Production of Documents at 3. The same day, respondents also filed a response to the Judgment Officer's sua sponte discovery requests, that as relevant here, stated that Crown did not recommend any of the trades executed for Sanchez's account. Gregory Marshall, identified as a principal of ITG, executed an affidavit stating that Crown was a principal during the relevant period, had supervisory authority, and held the title of president and general manager. Marshall stated that Sanchez's commissions were divided among Crown, ITG, Denn, TNT, and another ITG broker, Paul Brown ("Brown").

² With their answer, respondents submitted transcripts of taped compliance conversations and account statements. The account statements show that on February 29, 2000, TNT received Sanchez's wired initial deposit of \$20,000 and purchased on his behalf 20 calls for June unleaded gas for 1.85. By March 7, the value of Sanchez's June calls had risen to \$31,164. On that day, Sanchez purchased 10 July unleaded gas calls, paying \$9,870 for the premium and \$2,250.90 for commissions and fees, and, the next day deposited an additional \$12,120 to cover them. The very next day, however, his account nosedived: the value of Sanchez's June options had dropped to \$21,252 and the value of the July options to \$7,014. By March 23, the market value of his account had sunk to \$12,222. On April 20, Sanchez sold his 20 June unleaded gas options for \$4,620 and purchased seven silver call options, paying a \$1,820 premium and \$1,577.43 in commissions and fees. In early May, Sanchez liquidated his remaining positions. TNT issued checks for \$3,566.94 and \$4,199.10 on May 8 and 9. No further trading occurred.

Answering respondents' discovery questions, Sanchez said he had no tape recordings of conversations relating to his account. He also said that Crown asked him to invest an additional \$60,000 in corn or soybeans and said he could turn a \$25,000 investment into \$250,000 and that he declined Crown's overtures. With his discovery response, Sanchez included a motion to amend his complaint to add Crown, Brown, and a compliance officer as respondents, stating that, "Its [sic] all team work. Denn, Crown, Paul Brown, and the Compliance lady is in it too. All of these people contributed to the cause. I want to charge them as Respondent." The Judgment Officer inferred that Sanchez had alleged that Crown had facilitated Denn's and ITG's alleged fraud and failed to adequately supervise Denn. He added Crown as a respondent (but not the others) and ordered Crown to submit an answer. December 11, 2002 Order at 2.

Crown, acting *pro se*, filed a timely answer. He claimed that his only contact with Sanchez involved a trade recommendation that Sanchez rejected, and that he had limited supervisory authority over Denn. Acknowledging that his title was president and general manager, Crown nevertheless claimed that he had limited influence at ITG, and that Marshall had the real decision-making authority and had fired him.

Telephonic Hearing

A telephone hearing was held on February 6, 2003. Under questioning by the Judgment Officer, Sanchez indicated that he was poorly educated, had held menial jobs, was unemployed, and had little investment experience.³ Although unable to recall details of the advertisement that

³ Sanchez indicated that it took him unusually long to earn his high school degree and that he had taken a few trade school courses. Tr. at 7. Sanchez testified that he had worked as a mess attendant and as a laborer in an ammunition depot; since losing his job in 1985, he worked intermittently and received money from social services. Tr. at 8-10. Sanchez stated that his real estate experience was limited to the purchase and sale of his home and that he had invested in a mutual fund on the advice of a bank employee. Tr. at 10-11.

led him to contact ITG, Sanchez recalled that the message was generally very positive about the opportunity to make a lot of money. Tr. at 14.

Sanchez testified that in their initial conversations, Denn emphasized that he could make a lot of money in unleaded gasoline and that she did not ask much about his background.

Sanchez stated that he had already decided to open an account by February 28, when Denn faxed the account opening documents to him at his bank. Tr. at 24. He claimed that Denn rushed him through the account opening process, stressing the amount of money he was losing by taking so long. Sanchez stated that he deposited \$20,000 (wire-transferred from his bank), almost half of his life savings, because options trading sounded so good. Tr. at 27-28.

Sanchez said he followed Denn's trade recommendations because he:

trusted these people because of the way they were talking . . . at the beginning She even says . . . before this is over, we're going to get so close And she sold herself, you know, something like Mother Teresa maybe. . . . I was sold on the woman because I thought she was an honest person.

Tr. at 44. Sanchez testified that when the value of his June call options did in fact increase by about 53 percent, he told Denn that he thought it was time to get out, but she put him off, telling him first that she would get back to him; and stating later that she couldn't sell his contracts because "there [were] no buyers or something." Tr. at 47-48. Sanchez testified that he deposited additional funds to buy additional unleaded gas options on Denn's recommendation. Tr. at 128-30.

Sanchez testified that he spoke to Crown only once, after his gasoline options had declined significantly, telling Crown that he could not find \$60,000 to invest in soybeans, or the \$25,000 that Crown represented could bring a \$250,000 return. Crown did not persist. Tr. at 53. He said that from then on, he dealt with Brown, who told him that the oil and gas market had

⁴ Sanchez testified that Denn told him that he could have made \$7,000 in the time that it took to fill out the papers. Tr. at 27. Sanchez claimed that nothing was explained; he signed wherever Denn told him to sign. Tr. at 26.

collapsed and advised him to limit his losses by selling his gas positions and buying soybeans or silver. Tr. at 54-55, 62. Sanchez stated that although he did not understand how the market could have collapsed, he agreed to sell his unleaded gasoline options and purchase silver options. Tr. at 62-63. During cross-examination, Sanchez testified that he had listened to the tapes that had been produced by respondents during discovery, which recorded compliance conversations between ITG employees and himself disclosing risk and obtaining his consent to each trade. Tr. at 71. Sanchez confirmed that it was his voice on the compliance tape recordings. *Id*.

After Sanchez testified, the Judgment Officer examined Crown, who denied urging Sanchez to invest an additional \$60,000 or promising Sanchez that an investment of \$25,000 in soybeans would realize \$250,000. Tr. at 153-54. He did acknowledge asking Sanchez to invest additional funds and telling him that, "were he fortunate, he might be able to turn a 50 or 75 or 100 percent return, but only due to risk." *Id.* Crown asserted that Sanchez understood the investment and the risk and, at the hearing, was "playing possum . . . trying to act as if he [didn't] know anything." Tr. at 160.

Denn then testified. According to Denn, when Sanchez first phoned, she spent a considerable amount of time explaining the investment and its risk and rewards including the time sensitivity of the options and the possibility that Sanchez could lose his entire investment. Tr. at 178, 182, 194-96. Denn asserted that Sanchez "understood perfectly well" the investment and the risk, as she had spent over two hours discussing it with him; he discussed it intelligently; she did not believe that he was "following [her] blindly." Tr. at 180, 185-87.

Denn testified further that she faxed the paperwork to Sanchez at his request because he did not want to wait for the package that she had sent priority mail. Tr. at 188. She said she faxed incomplete risk disclosure because Sanchez was using a free service at the bank and time

was important. Tr. at 219-20. She acknowledged that she substituted a three- or four-page newspaper article for the complete risk disclosure statement required to be furnished to options customers. Tr. at 220. She insisted that after his initial trade earned a substantial profit, Sanchez refused her subsequent recommendations to sell. Tr. at 198-99, 204-07.

Dennis Rogers ("Rogers"), the director of compliance at ITG, testified that he monitored the brokers' activities and phone calls; he was "in charge of the oversight of the compliance people who actually recorded the trades and the initial compliance procedures for the customers." Tr. at 230. Rogers said that all compliance procedures were followed with respect to Sanchez's account and that Sanchez was an appropriate customer, considered in light of his financial condition. Tr. at 244. Rogers said that in his experience, many customers "have no interest in really understanding the investment," *i.e.*, the mechanics of trading, "but that's neither here nor there." Tr. at 243.

Initial Decision

The Judgment Officer issued a decision in Sanchez's favor, finding "Sanchez's version of events was significantly more plausible and compelling than respondents' version." I.D., ¶
29,487 at 55,091. He concluded that respondents defrauded Sanchez by providing a heavily lopsided picture of the relative risks and rewards of trading. The Judgment Officer stated that while Sanchez was hindered in presenting his case by a lack of sophistication, his failure to master trading terminology, and his "confusion about the . . . chronology of conversations,"
Sanchez's version of events nevertheless "jibe[d] with the overall evidentiary record." I.D. at 55,094.

The Judgment Officer discredited respondents' testimony. He found Denn's credibility undercut by her submission of an answer based on a form answer that her attorney had filed on

behalf of other respondents in other cases and her inability to elaborate on it. I.D. at 55,094-95. He dismissed Crown's testimony as unconvincing and "at times brazenly mendacious." I.D. at 55,094. In particular, he found that Crown's assertions that Sanchez understood the risks, and was acting less knowledgeable at the hearing than he did when he traded, were contradicted by Sanchez's limited education and trading experience, and the taped compliance review which revealed that Sanchez lacked a rudimentary understanding of the trading he was engaged in. *Id.*

The Judgment Officer found that Denn told Sanchez that ITG consistently picked highly profitable option trades that were safe and certain to generate tremendous profits; that she would educate him as she traded his account; and that she did not correct his misimpressions. I.D. at 55,095-96, 55,104. He found that Denn called Sanchez before the account package had arrived and urged him to go to his bank and wire \$20,000 to ITG. Denn then faxed newspaper articles and parts of the account opening documents—leaving out the pages with the core warnings about risk. I.D. at 55,096, 55,105. The Judgment Officer described ITG's initial compliance interview as an "artifice designed to gloss over" rather than cure customer misunderstanding about the risks of trading options. I.D. at 55,098.

The Judgment Officer found that ITG's written disclosures did not cure the false impression of guaranteed profits Denn created because she failed to provide the complete disclosure statement and because the overall effect of her "intentionally deceptive" statements "outweighed and vitiated" the written risk warnings. I.D. at 55,106. Acknowledging that Crown was unsuccessful in his efforts to induce Sanchez to submit additional funds, the Judgment Officer nevertheless held that Crown's actions perpetuated and concealed Denn's fraud, and that he breached his duty to supervise her. *Id.* The Judgment Officer held ITG liable as Denn's and

Crown's principal and TNT liable as ITG's guarantor. He ordered respondents to pay Sanchez his out-of-pocket loss of \$24,396, plus interest and costs. Respondents' appeals followed.⁵

On appeal, Denn challenges the Judgment Officer's factual findings, claiming that he did not properly weigh Sanchez's obvious memory problems and the repeated risk disclosures he was given. Denn also raises two procedural issues: (1) Sanchez never produced a tape recording mentioned for the first time at the hearing; and (2) Sanchez's statements during the hearing suggested that he engaged in prohibited *ex parte* communications with the Judgment Officer prior to the hearing. Crown claims that he was denied a fair hearing and emphasizes that Sanchez, without explanation, absented himself from the hearing before it concluded. He notes that he had minimal contact with Sanchez and that Sanchez rejected his advice. ITG/TNT contend that the Judgment Officer erred by adding Crown as a party. IGT/TNT also claim that they were denied due process based on the Judgment Officer's mishandling of Sanchez's missing tape recording and Sanchez's alleged *ex parte* communication with the Judgment Officer. They assert that the Judgment Officer abused his discretion by issuing one-sided discovery orders about issues not raised by Sanchez.

DISCUSSION

Under our precedent, we generally defer to a presiding officer's credibility determinations in the absence of clear error, but review factual assessments based on those credibility determinations *de novo*. *Nobrega v. Futures Trading Group, Inc.*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,267 at 50,616 (CFTC Sept. 29, 2000), *citing Bishop v. First Investors Group of the Palm Beaches, Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,004 (CFTC March 26, 1997).

⁵ Respondents Crown and Denn filed independent appeals. Denn is represented by counsel. Crown is *pro se*. ITG and TNT filed a joint appeal ("ITG/TNT").

Denn's and ITG's Liability

The Judgment Officer found that Denn fraudulently misrepresented the profit potential of options while failing to disclose risk adequately. As to the latter finding, Denn admitted at the hearing that respondents opened and began trading Sanchez's account before he received the risk disclosure required by Commission Rule 33.7. Tr. 219-20. That rule forbids opening an account until the broker receives a signed acknowledgement from the option customer that he "received and understood the disclosure statement." 17 C.F.R. § 33.7(a)(1)(ii). Denn admitted that respondents opened and traded Sanchez's account after receiving a faxed copy of his signed acknowledgement, although they knew that the document he acknowledged "receiving" and "understanding" was only the signature page and the full document had not reached him through the mail. ⁷

[N]o futures commission merchant, or . . . introducing broker, may open or cause the opening of a commodity option account for an option customer . . . unless the futures commission merchant or introducing broker first:

- (i) Furnishes the option customer with a separate written disclosure statement as set forth in this section or another statement approved under §1.55(c) of this chapter and set forth in Appendix A to §1.55 which the Commission finds satisfies this requirement, or includes either such statement in a booklet containing the customer account agreement and other disclosure statements required by Commission rules; provided, however, that if the statement contained in §33.7 is used it must follow the statement required by §1.55; and . . .
- (ii) [R]eceives from an option customer an acknowledgment signed and dated by the option customer that he received and understood the disclosure statement.

Judge: On these account opening documents, I'm looking at the set that was faxed to him. . . . We have some newspaper articles and signature pages. Do you recall why it is that you didn't bother to send him a complete copy of the risk disclosure statement and a complete copy of the contract?

Denn: He advised me that this information was going to his bank, that this was a free service, but he couldn't spend much time.

Judge: Well, why did you send a newspaper article which is three or four pages, and instead send the same number of pages, which would have given him a complete risk disclosure statement and a complete copy of the contract?

⁶ Commission Rule 33.7(a)(1) states in pertinent part:

⁷ The following colloquy occurred:

Respondents' failure to comply with Rule 33.7 raises a rebuttable presumption that Sanchez relied on the nondisclosure in opening his account. *Knight v. First Commercial Financial Group, Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,942 at 44,555 (CFTC Jan. 14, 1997), *citing Sher v. Dean Witter Reynolds, Inc.*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. ¶ 22,266 at 29,371 (CFTC June 13, 1984). To rebut this presumption, respondents needed to show that they actually disclosed the risks of futures trading to Sanchez or that he was otherwise aware of those risks. *Knight, supra, citing Batra v. E.F. Hutton & Co., Inc.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. ¶ 23,937 at 34,287 (CFTC Sept. 30, 1987), *aff'd sub nom. Batra v. Commodity Futures Trading Commission*, 845 F.2d 1020 (5th Cir. 1988), *cert. denied*, 488 U.S. 995 (1988).

Sanchez had not traded futures or options before and his investment experience was limited to buying and selling his residence and investing in a bank-sponsored mutual fund. He had little formal education and had not worked in jobs that exposed him to financial instruments and their risk. Accordingly, he had nothing in his own background to draw on to evaluate the risk of options trading, especially deep-out-of-the-money options. In opening his account, he had to rely on what respondents told him. Oral statements regarding risk, standing alone, are insufficient to rebut the presumption that a complainant relied on the nondisclosure, especially in these circumstances, where the risk was minimized. Therefore, we find that Sanchez relied on the nondisclosure in opening his account. Rule 33.7 places the responsibility on the firm to

Denn: The only reason that I can think of is that he had requested it.

Tr. at 219-20.

⁸ The transcript of Sanchez's conversation with ITG's compliance officer shows that the officer glossed over risk. To the extent risk was discussed, she stressed that he could not lose more than his entire investment, but mentioned only in cursory fashion the potential for his losing some or all of that investment. See generally Tr. of Compliance tape at 9-10, 14, 17-18 (Feb. 29, 2000).

provide the risk disclosure statements. Consequently, ITG is liable for the failure to provide Sanchez with the required risk disclosure statement. Denn is liable as an aider and abettor under Section 13(a) of the Act.

Denn's fraud did not end with failing to provide required risk disclosure. Denn's oral statements to Sanchez stressed the likelihood of high profits while downplaying the risk of loss. Her salesmanship proved so effective that Sanchez: (1) allowed her to fax account opening documents to his bank instead of waiting for priority mail; and (2) wire-transferred money to begin trading as quickly as possible. Denn testified that she accelerated account-opening procedures because Sanchez told her he did not "want to wait that long." Tr. at 188. These undisputed circumstances tend to corroborate Sanchez's assertions that Denn told him options prices were going to "sky rocket" and that he was losing thousands of dollars the very day they spoke because he was not in the market.

Although solicitations involving the use of "high pressure" sales techniques generally are not unlawful in the absence of other fraud, 9 such marketing tactics become problematic when they are "designed to prevent customers from making reasoned investment decisions." *In re British American Commodity Options Corp.*, 1977 WL 13558 at *12 (CFTC Dec. 2, 1977). This occurs, for example, when a broker imparts a sense of urgency, pushing a customer to take advantage of immediate opportunities for high profits, when in fact there is no need to act in such a hasty fashion. The fraud in such instances involves the false claim that there is a need to act quickly rather than a general notion of pressure by a salesman. Such pressure can nonetheless tend to contribute to a consumer's ultimate deception by increasing the likelihood that he will

⁹ The articulation of this principle in a decision by a Commission Judgment Officer captures the sense of what we intend to convey. See Richardson v. First Commodity Corp. of Boston, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,661 at 33,719 (Init. Dec. Jun. 12, 1987) (use of high pressure sales tactics "by themselves" do not violate Federal commodities law). Cf. In re Horizon Corp., 97 FTC 464, 841-42 (1981) ("unwarranted sales pressure," without more, not legally unfair).

accept and act on other statements by the broker which are deceptive. As a matter of practice, therefore, we will carefully scrutinize such sales tactics when they occur in conjunction with material misrepresentations concerning the need to take immediate action or the likelihood of attaining profits. *Cf. In re Amrep Corp.*, 102 FTC 1362, 1662-63 (1983) (practice of misleading consumers into believing they have to purchase immediately to avoid imminent price increases is deceptive trade practice).

Here, Denn's high pressure sales pitch was deceptive because, as previously mentioned, it incorporated affirmative statements that misled Sanchez into believing that he had to purchase immediately in order to take advantage of a highly profitable investment opportunity. Its use made it likely that Sanchez would decide to trade in reliance on those deceptive representations, and therefore facilitated Denn's efforts to mislead him.¹⁰

Based on the foregoing, we affirm the Judgment Officer's conclusion that Denn fraudulently induced Sanchez to trade based on material misrepresentations of the likelihood of profits, and material omissions of the risk that he was assuming.

Crown's Liability

We find that liability against Crown has not been established, and we therefore dismiss the complaint against him. The Commission's liberal pleading rules, the leeway afforded *pro se* complainants, as well as respondents' numerous references to Crown in their early pleadings support the Judgment Officer's decision to add him as a respondent.¹¹ Crown had notice of the

¹⁰ See generally Amrep, 102 FTC at 1663 (high pressure sales tactics constitute deceptive trade practice when they "facilitate[] respondent's efforts to mislead consumers").

¹¹ See Hall v. Diversified Trading Sys., Inc., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,131 at 41,751 (CFTC July 7, 1994) (holding that a customer's complaint must include "an intelligible description of the conduct the complainant alleges to be in violation of the [Commodity Exchange] Act"); Marvin v. First Nat'l Monetary Corp., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,046 at 37,910 (CFTC Apr. 17, 1991) ("In maintaining the fairness and informality of its reparations process, [the Commission] has to balance a pro se

failure to supervise allegation and other alleged violations through the Judgment Officer's order granting Sanchez's motion to amend his complaint. The order stated:

Sanchez's complaint, as supplemented by other evidence in the record, supports a cognizable claim that Crown facilitated Denn's and ITG's alleged fraud in violation of Section 4c(b) of the Commodity Exchange Act and CFTC rule 33.10, that Crown failed to adequately supervise Denn in violation of CFTC rule 166.3, and that these violations caused . . . damages. Accordingly, pursuant to CFTC rules 12.201 and 12.204 for good cause shown, Sanchez's request to amend the complaint to add Bruce Norman Crown as a respondent is GRANTED.

Order Granting Complainant's Motion to Amend Complaint by Adding Bruce Norman Crown as Respondent (Dec. 11, 2002). The complaint was amended and served on Crown, giving him an opportunity to answer, appear and defend, all of which he did.

The record shows, however, that Crown was unsuccessful in his attempt to induce Sanchez to deposit more money, and Sanchez did not offer any evidence that he relied on anything Crown said. Moreover, Sanchez testified that this unsuccessful solicitation was his sole contact with Crown. In these circumstances, the Judgment Officer's finding that Crown reinforced Denn's fraud lacks sufficient support in the record to withstand review.

We turn to the Judgment Officer's finding that Crown failed to supervise Denn diligently.

Commission Rule 166.3 states:

Each Commission registrant, except an associated person who has no supervisory duties, must diligently supervise the handling by its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) of all commodity interest accounts carried, operated, advised or introduced by the registrant and all other activities of its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) relating to its business as a Commission registrant.

"The objective of Regulation 166.3 is to protect customers from fraudulent or manipulative activities of Commission registrants." *Modlin v. Cane*, [1996-1998 Transfer

complainant's need for liberal interpretation of its pleadings against respondent's constitutionally-protected right to notice of the charges against him and a fair opportunity to defend.").

Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,392 at 46,809 (CFTC July 30, 1998) citing In re Paragon Futures Association, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. ¶ 25,266 at 38,850 (CFTC April 1, 1992). Failure to supervise is an independent and primary violation of the Commission's rules. Paragon, ¶ 25,266 at 38,849.

When it adopted the rule, the Commission stated that its "basic purpose . . . is to protect customers by ensuring that their dealings with the employees of Commission registrants will be reviewed by other officials in the firm." Customer Protection Rules, 43 Fed. Reg. 31,886, 31,889 (July 24, 1978). Nonetheless, in proposing this rule, the Commission specifically recognized that "the performance of a wrongful act by an employee . . . does not necessarily mean that the employee was improperly supervised, although it is often a strong indication of a lack of proper supervision." Protection of Commodity Customers, 42 Fed. Reg. 44,742, 44,747 (Sept. 6, 1977). The focus of an inquiry to determine whether Rule 166.3 has been violated is on whether review occurred, and if it did, whether it was diligent. *In re First Investors Group of the Palm Beaches*, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. ¶ 29,767 at 56,210 (CFTC May 24, 2004).

In a reparations case, to establish a violation of Rule 166.3, a complainant must show more than a supervisory relationship and a violation of the Act leading to damages. *Bunch v. First Commodity Corp. of Boston*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,352 at 39,168 (CFTC Aug. 5, 1992), *citing Callahan v. Delphi Commodities, Inc.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,060, at 34,645 n.4 (CFTC Dec. 18, 1987). In assessing an alleged violation of Rule 166.3, the Commission focuses on: (1) the nature of a respondent's system of supervision; (2) the supervisor's role in that system of supervision; and (3) evidence that the supervisor did not perform his assigned role in a diligent manner. In

addition, a complainant must establish that the supervisor's breach of duty played a substantial role in the wrongdoing that proximately caused the damages. *Id.* at 39,168-69. To find an individual supervisor liable, the complainant must show either that the respondent had knowledge of wrongdoing and failed to take reasonable steps to correct the problem, or that the respondent failed to discharge specific responsibilities of supervision. In addition, it must be shown that respondent's failure was the proximate cause of complainant's damages. *Id.* at 39,169.

Crown's testimony included an explanation of ITG's system of supervision and his role in it. See generally Tr. at 135-46. Crown testified that, at the time at issue, he was the president and manager of ITG; his duties included instructing, training, and overseeing brokers. Tr. at 135. Subject to Marshall's approval, Crown established the compensation package (which included his share in the brokers' commissions) and hired and fired brokers. Tr. at 141. He confirmed that he was responsible for implementing, monitoring, and enforcing policies and procedures to detect, deter, and prevent fraudulent sales practices and other violations and that he was required to report any material problems to Marshall. Tr. at 141-42. Crown was responsible for reviewing the trading activity in all of the brokers' accounts, including Denn's, and was aware of Sanchez's account and his situation. Tr. at 142-43. Denn's fraudulent solicitation of Sanchez standing alone, however, "does not necessarily mean that [she] was improperly supervised." Protection of Commodity Customers, 42 Fed. Reg. at 44,747.

While Crown may have been aware of the status of Sanchez's account, there is no evidence that Crown was aware of Denn's material misrepresentations to him. Neither Crown nor Denn testified about his oversight of her conversations with Sanchez. There is no evidence that he listened to the conversations between Denn and Sanchez or discussed them with her, or

that there were other factors that should have put him on notice to watch her more closely. Since the evidence does not show that Crown had knowledge of Denn's wrongdoing and failed to take reasonable steps to correct the problem or that he failed to discharge specific responsibilities of supervision, we conclude that there is not enough evidence to find that Crown failed to supervise Denn diligently in relation to her fraudulent solicitation of Sanchez. Accordingly, we vacate the Judgment Officer's finding that Crown violated Rule 166.3.

Crown also testified that the compliance director, Rogers, not Crown himself, was responsible for the explanation of risk and that the compliance department reviewed account opening documents. Tr. at 147-48. Rogers confirmed Crown's testimony by acknowledging that he performed the compliance responsibilities at ITG and was "in charge of the compliance people who actually recorded the trades and the initial compliance procedures for the customers." Tr. at 230. Rogers, not Crown, had the duty to supervise Denn and her compliance with the obligation to provide the required risk disclosure statement before she began trading customer accounts. Rogers, however, is not a party to this proceeding.

Procedural Issues

Respondents make much of the Judgment Officer's alleged procedural errors, which are either harmless or actions within his discretion. Furthermore, our disposition does not rely on any of the alleged errors.

a. Respondents charge that the Judgment Officer did not allow them to question Sanchez about the contents of a tape in his possession that was responsive to discovery requests, but was not produced and the existence of which was not known until the hearing. In this circumstance, the appropriate sanction would be an adverse inference. In re Nikkhah, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,462 at 55,001 (CFTC Apr. 11, 2003); Residential

Funding Corporation, v. DeGeorge Financial Corp., 306 F.3d 99, 113 (2nd Cir. 2002). Sanchez indicated that he "sound[s]...dumb" on the tape. Tr. at 161. In this case, the appropriate adverse inference would be that the tape does not show that Sanchez is manifestly dumb or stupid. Such an adverse inference would not alter the outcome of the case. An inference that a person is not stupid does not mean that the person has sufficient background to evaluate trading risk. Sanchez's education, experience and demeanor at the hearing, as well as the transcript of his compliance interviews, manifestly demonstrate that he was not knowledgeable about options trading.

b. Respondents allege that the Judgment Officer inappropriately limited their cross-examination of Sanchez. An effort to undermine a complainant's portrayal of himself as naïve and trusting may be central to a respondent's defense. McDaniel v. Amerivest Brokerage

Services, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,264 at 50,588 (CFTC Sept. 26, 2000). A party is deprived of an opportunity for a fair hearing if the presiding officer interferes with impeachment of a witness through cross-examination. Id. When a line of questioning, however, attempts to highlight inconsistencies already in the record and statements already transcribed, the presiding officer may cut off the cross-examination. Modlin, ¶ 28,059 at 49,552 n.22. Once a party has made his point, further cross-examination on the same topic is not necessary. Accord, In re Glass, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,337 at 46,561-62 (CFTC Apr. 27, 1998). Respondents were able to ask sufficient questions to show inconsistencies in Sanchez's testimony, rendering further questioning unnecessary.

McDaniel, ¶ 28,264 at 50,588.

¹² E.g., Sanchez equivocated about his net worth. Tr. at 101. Although his account-opening form stated otherwise, Sanchez testified that his net worth was not "even close to" \$80,000, but later claimed that "at the time between the property and what I had in the bank... [he] thought it would come up to that...." Tr. at 93-94. Sanchez asserted that Denn knew that he did not have an income of \$25,000 and that he was taking the money from his savings

c. Respondents also charge that the Judgment Officer and Sanchez engaged in prohibited ex parte communications. The record indicates that the Judgment Officer had three conversations with Sanchez when none of the other parties were present. Two of these involved oral requests for extensions of time, which were not prohibited ex parte communications because extensions of time are not relevant to the merits of the proceeding. See Commission Rule 12.7.

The third conversation came to light in a colloquy between Sanchez and the Judgment Officer during the hearing and concerned the above-mentioned missing tape recording. Sanchez stated that he had informed the judge earlier in the proceeding that he had taped broker Paul Brown's solicitation and the judge expressed no interest in it. The Judgment Officer responded that at the time, he thought Sanchez was referring to tapes of settlement negotiations (which he appropriately did not want to hear), not the merits of the case. Tr. 164, 166. See generally I.D., ¶ 29,487 at 55,106 (noting the limited references to Brown in the record). Without evidence to the contrary, the Judgment Officer's version of the conversation—a conversation tangential to the merits of the case against Denn—should stand. The Commission applies a presumption of impartiality and honesty to its presiding officials. Miller v. FCCB, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,577 at 33,517 (CFTC Apr. 21, 1987). The Judgment Officer's explanation that he misunderstood Sanchez is credible, especially given Sanchez's communication style.

d. We reject respondents' contentions that Sanchez should be sanctioned for abandoning his prosecution by absenting himself from the hearing without explanation. Without speculating on whether he had good reason for his action, we observe that he appeared at the hearing,

account. He entered \$25,000 on his account-opening form because that was the minimum income necessary to open an account. Tr. at 97. See also Tr. at 71-72 (Sanchez implausibly suggested that the compliance tapes had been altered).

19

tendered his case in chief and offered himself for cross-examination. The only person who faced potential injury from his absence was Sanchez himself.

e. Lastly, respondents assert that the Judgment Officer abused his authority to conduct sua sponte discovery by exploring extraneous issues, such as respondents' corporate structure and the nature of deep-out-of-the-money options. These issues were suggested by the parties' pleadings. Any overbreadth was harmless, since neither the initial decision nor our analysis rests on information gathered (or not made available) in the course of sua sponte discovery.

CONCLUSION

Based on the foregoing, we find that ITG failed to provide Sanchez with the risk disclosure statement required by Commission Rule 33.7, and that Denn aided and abetted ITG's violation. We also find TNT derivatively liable under Section 2(a)(1)(B) of the Act for the violations of Denn and ITG. We affirm the Judgment Officer's findings that Denn fraudulently induced Sanchez to open a commodity options account by overstating the likelihood of profit and that ITG and TNT are derivatively liable for Denn's violations under Section 2(a)(1)(B) of the

Act. We vacate those portions of the I.D. that find Crown liable and dismiss the complaint against him. We affirm the \$24,396 award of Sanchez's out-of-pocket damages. Denn, ITG, and TNT are jointly and severally liable.¹³

IT IS SO ORDERED.14

By the Commission (Chairman JEFFERY and Commissioners LUKKEN, BROWN-HRUSKA, HATFIELD and DUNN).

Catherine D. Daniels

Assistant Secretary of the Commission Commodity Futures Trading Commission

il. Daniel

Dated: January 18, 2006

A party who receives a reparation award may sue to enforce the award if payment is not made within 15 days of the date the order is served by the Proceedings Clerk. Pursuant to Section 14(d) of the Act, 7 U.S.C. § 18(d) (2000), such an action must be filed in a United States District Court. See also 17 C.F.R. § 12.407.

Pursuant to Section 14(f) of the Act, (7 U.S.C. §18(f) (2000), a party against whom a reparation award has been made must provide to the Commission, within 15 days of the expiration of the period for compliance with the award, satisfactory evidence that (1) an appeal has been taken to the United States Court of Appeals pursuant to Section 6(c) and 14(e) of the Act, or (2) payment has been made of the full amount of the award (or any agreed settlement thereof). If the Commission does not receive satisfactory evidence within the appropriate period, such party shall be automatically prohibited from trading on all contract markets and its registration under the Act shall be suspended automatically. Such prohibition and suspension shall remain in effect until such party provides the Commission with satisfactory evidence that payment has been made of the full amount of the award plus interest thereon to the date of payment.

¹³ The award of prejudgment interest at the rate established in the initial decision, and the award of the filing fee, shall stand.

¹⁴ Under Sections 6(c) and 14(e) of the Commodity Exchange Act (7 U.S.C. §§ 9 and 18(e) (2000), a party may appeal a reparation order of the Commission to the United States Court of Appeals for only the circuit in which a hearing was held; if no hearing is held, the appeal may be filed in any circuit in which the appellee is located. The statute states that such an appeal must be filed within 15 days after notice of the Commission order, and that any appeal is not effective unless, within 30 days of the effect of the order, the appealing party files with the clerk of the court a bond equal to double the amount of the reparation award.